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UNCLAS SECTION 01 OF 02 JERUSALEM 000511

SIPDIS

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DEMARCELLUS; NSC FOR PASCUAL; TREASURY FOR CONNOLLY
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SUBJECT: PA HOLDING THE BUDGET LINE, BUT DECLINE IN DOLLAR
INCREASES FISCAL GAP

REF: JERUSALEM 169

11. (SBU) Summary. The IMF reports that the PA's total financing needs for 2008 are now forecast at more than USD 2.1 billion (up from 1.8 billion in December). The IMF notes that donor contributions to date (including USG assistance) have been sufficient to sustain PA operations, but at current exchange rates, if all announced and pledged 2008 budget support is delivered, the PA will still face a gap of USD 570 million this year. The team's findings will form the basis for the IMF's report to the AHLC meeting in May. End Summary.

PA Holds Down Costs, But Fiscal Gap Grows

12. (SBU) An IMF team reported its findings to local donor representatives during the week of March 17. Mission Head Oussama Kanaan told donors that the PA has maintained "strict control" on payroll costs, including by refusing a general salary increase and by maintaining the payroll levels at totals agreed in December. In addition, collection rates for utility payments have increased dramatically and are expected to reach 80% by the end of the year. These actions are forecast to slash the PA's net lending costs by one-third (from NIS 2.2 billion in 2007 to NIS 1.44 billion in 2008). In all, Fayyad's actions have cut the PA's expected operating deficit by NIS 200 million in 2008.

13. (SBU) Despite these measures, however, the fall of the dollar and a more aggressive PA effort to pay its debts has increased the dollar-denominated fiscal gap in 2008. The three-year framework presented to donors in December was calculated at an exchange rate of 4.1 NIS/USD. The IMF and PA have redone the numbers based on a 3.6 NIS/USD rate, although the dollar has fallen as low as 3.4 NIS/USD recently. Although the PA's revenues and expenditures are almost entirely in NIS, a number of significant donors, including the U.S. and the GCC states, contribute in dollars. The IMF now calculates that the dollar-denominated budget deficit - for recurrent expenditures only - in 2008 will total USD 1.63 billion (USD 135 million/month). Combined with the public infrastructure investments included in the PRDP, the total external financing needed in 2008 is more than USD 2.1 billion.

Donors Stepping Up
But a Large Gap Looms

14. (SBU) Kanaan and IMF Country Representative Toujas-Bernate noted that March contributions - including the U.S. cash

transfer of USD 150 million - are sufficient to pay salaries and other recurrent expenses through May. The World Bank will also disburse approximately USD 150 million from its trust fund between now and May, including USD 40 million of its own funds.

¶5. (SBU) Looking ahead, Toujas-Bernate said that if all pledged budget support is delivered at current exchange rates, the PA will receive approximately NIS 3.9 billion in 2008 (out of a need for nearly NIS 5.9 billion), leaving a gap of NIS two billion (USD 570 million) for which there are no donors currently identified.

Access and Movement -----

¶6. (SBU) The IMF said GOI restrictions on access and movement had not been relaxed as had been forecast when the PA put together its three-year budget. Some restrictions had, in fact, been tightened. The IMF has not yet changed the framework's basic assumptions, admitting that it was too early to understand fully the impact on economic growth. The IMF has, however, downgraded its forecast growth in the Palestinian economy from 3.5 to 3 percent in 2008.

¶7. (SBU) The PM's economic adviser, Karim Nashishibi, said that on the issue of economic growth, he was as concerned about a possible slowdown in the Israeli economy, the PA's largest export market. Nashishibi agreed with the IMF that it was too early to dramatically adjust growth forecasts based on access and movement restrictions, as "inside some West Bank cities growth has picked up more than expected."

¶8. (U) The IMF briefing on the PA's Public Financial

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Management structures, as well as the updated fiscal framework tables (in USD and NIS) can be found on ConGen Jerusalem's unclassified intelink site at:
http://www.intelink.gov/communities/state/pal_econ.
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